

## A Restoration of Certainty: Strict Products Liability and Successor Corporations

The law of products liability has been with us in one form or another since the middle of the 19th century.<sup>1</sup> Its scope has been continually expanding ever since. Barriers to recovery such as negligence, warranty, and contractual privity have been weakened and removed.<sup>2</sup> Potential plaintiffs now include users, purchasers, and even bystanders.<sup>3</sup> Defendants include all members of the manufacturing and marketing chain—retail and wholesale sellers, processors, and marketers.<sup>4</sup> One defendant traditionally absent from this list has been the successor corporation.<sup>5</sup> Until recently the liability of a corporate transferee for damages or injuries caused by products manufactured by its predecessor had been limited, with few exceptions, to obligations expressly assumed at the time of the transfer.<sup>6</sup>

Lately, however, the legal rights and responsibilities of successors have been subject to increasing scrutiny. Economic conditions in the last decade, marked by upward-spiraling wages, prices, and interest rates, have resulted in a pronounced increase in corporate acquisitions and mergers.<sup>7</sup> Consequently, persons injured by defective products often discover that the original manufacturer is no longer in existence, and the propriety and desirability of an action against the successor has acquired a previously unattained significance. How the issue is finally resolved concerns everyone: the injured party, the successor corporation, and the public at large, which must ultimately bear the cost of defective product injuries through higher prices or, should the burden fall upon publicly financed compensation programs, through higher taxes.

The purpose of this Comment is not to suggest that all successor corporations should be held liable for dangerously defective products manufactured by their predecessors. It is, rather, to define circumstances in which it is both equitable and socially desirable to do so. In most cases the relevant inquiry will be the extent to which the successor's business is a substantial continuation of the business of the transferor, in terms of product line, management, or product name.<sup>8</sup> This Comment advocates that a successor corporation should

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1. R. EPSTEIN, MODERN PRODUCTS LIABILITY LAW 9 (1980). *Winterbottom v. Wright*, 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842), is commonly cited as the first products liability case.

2. See generally MACHINERY AND ALLIED PRODUCTS INSTITUTE COUNCIL FOR TECHNOLOGICAL ADVANCEMENT, PRODUCTS LIABILITY AND RELIABILITY 13-21 (1967).

3. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 662-63 (4th ed. 1971).

4. *Id.* at 663-65.

5. For purposes of this Comment, the term "successor corporation" will be used in a general sense to refer to any corporation that has combined with another corporation or corporations through merger, consolidation, stock purchase, asset purchase, or otherwise.

6. See generally Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142 (1980).

7. Lipton & Steinberger, *Introduction*, 23 N.Y.L. SCH. L. REV. 375 (1978).

8. See *infra* text accompanying notes 99-124.

be presumed liable for defective products manufactured by an acquired entity unless the successor can show that it has in no way benefitted from the activities of the predecessor as a continuation of its business. This method of analysis will stabilize the law of successor corporation strict products liability and will protect persons injured by dangerously defective products unless it is clearly inequitable to do so.<sup>9</sup>

Parts one and two below examine the strict products liability and corporate law positions in some detail.<sup>10</sup> A marked and perhaps irreconcilable conflict between the policies of the respective rules will be readily apparent. Part three analyzes this policy conflict and examines how the courts have dealt with it in corporate acquisitions.<sup>11</sup> Part four explains how this conflict of interests can be resolved through a presumption of successor liability and the possible rebuttal of this presumption.<sup>12</sup> Finally, part five examines the consequences of adopting this new approach.<sup>13</sup>

## I. THE STRICT PRODUCTS LIABILITY THEORY

The purpose of the rule of strict tort liability<sup>14</sup> "is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves."<sup>15</sup> Strict liability arises regardless of the culpability of the party charged, even if all possible care was exercised in the construction and sale of the product.<sup>16</sup>

The cause of action was created primarily to cope with the increasingly complex nature of manufactured products.

In today's world it is often only the manufacturer who can fairly be said to know and to understand when an article is suitably designed and safely made for its intended purpose. Once floated on the market, many articles in a very real practi-

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9. *Id.*

10. See *infra* notes 14-46 and accompanying text.

11. See *infra* text and notes 47-98.

12. See *infra* text and notes 99-124.

13. See *infra* text and notes 125-42.

14. The general rule of strict liability is contained in the *Restatement (Second) of Torts* § 402A: Special Liability of Seller of Product for Physical Harm to User or Consumer

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

RESTATEMENT (SECOND) OF TORTS § 402A (1965).

15. *Greenman v. Yuba Power Prod., Inc.*, 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

16. RESTATEMENT (SECOND) OF TORTS § 402A (1965). Limited defenses are available to manufacturers in products liability suits. The two defenses most frequently asserted are misuse and unavoidable unsafeness of the product. See *id.* comments h and k.

cal sense defy detection of defect, except possibly in the hands of an expert after laborious and perhaps even destructive disassembly.<sup>17</sup>

Strict liability therefore places the burden of producing a safe product on the manufacturer, which alone has the opportunity and business incentive to turn out safe products and to correct defects.

Strict liability attaches to any manufacturer or any seller of a product, on a retail or wholesale level, including the maker of a component part of the final product.<sup>18</sup> Plaintiffs seeking to recover for injuries caused by defective products under a strict products liability theory must establish (1) that the injury was caused by the allegedly defective product, (2) that the product was in fact defective and thus unreasonably unsafe, and (3) that the product was defective when it left the hands of the particular defendant.<sup>19</sup>

The policy behind placing responsibility for product safety on the manufacturer is one of risk-spreading and fairness. Public interest in human life and safety demands broad protection against the sale of defective products. Manufacturers solicit the use of their products by representing, expressly or implicitly, that they are safe and suitable for use. Therefore, strict liability theory places responsibility for losses caused by dangerously defective products on the party that has created the risk and that has subsequently profited by introducing the defective product into the stream of commerce.<sup>20</sup> Judge Traynor, in *Escola v. Coca Cola Bottling Co.*,<sup>21</sup> captured the compelling nature of the strict liability action from a social perspective:

Even if there is no negligence . . . public policy demands that responsibility be fixed whenever it will most effectively reduce the hazards to life and health inherent in defective products. . . . Those who suffer injury from defective products are unprepared to meet its consequences. The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business. It is to the public interest to discourage the marketing of products having defects that are a menace to the public. . . . However intermittently such injuries may occur and however haphazardly they may strike, the risk of their occurrence is a constant risk and a general one. Against such a risk there should be general and constant protection and the manufacturer is best situated to afford such protection.<sup>22</sup>

This tort policy, however, runs counter to the policy behind corporate law, which until recently has governed the strict products liability of successor corporations.<sup>23</sup>

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17. *Codling v. Paglia*, 32 N.Y.2d 330, 340, 298 N.E.2d 622, 627, 345 N.Y.S.2d 461, 468 (1973).

18. W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 663-64 (4th ed. 1971).

19. *Id.* at 671-72.

20. Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142, 143 (1980).

21. 24 Cal. 2d 453, 150 P.2d 436 (1944).

22. *Id.* at 462, 150 P.2d at 440-41 (Traynor, J., concurring).

23. See *infra* text accompanying notes 49-51.

## II. CORPORATE LAW

Corporate ownership of an enterprise may, in general, be transferred in three ways: (1) by statutory merger or consolidation, (2) through a sale of all of the stock of the transferor corporation to the transferee corporation, or (3) by a sale of assets by the transferor corporation to the transferee corporation,<sup>24</sup> a situation fraught with the most complex successor assumption of strict liability issues.

In a statutory merger or consolidation<sup>25</sup> the surviving or consolidated corporation takes over the assets of the constituent corporation or corporations, assumes any liabilities, and issues common shares or pays other appropriate consideration in exchange for the shares of the corporation to be consolidated or absorbed.<sup>26</sup> In other words, the acquired entity becomes an inseparable part of the acquiring corporation. This type of combination is strictly governed by state statute and is usually effected by filing with the Secretary of State an agreement approved by both sets of shareholders.<sup>27</sup> Because consolidated or absorbed entities completely lose their corporate identities,<sup>28</sup> most statutes impose the liabilities (including strict products liability) of the merged or consolidated corporation on the transferee.<sup>29</sup> Therefore, statutory consolidations and mergers present little problem for the strict liability plaintiff—recovery from the successor is expressly permitted by law. A variation on the statutory merger theme is the so-called de facto merger.<sup>30</sup> This equitable doctrine favors substance over form and invokes statutory merger requirements when the combination is judicially deemed to have the same practical effect.<sup>31</sup>

The second method of transferring corporate property is a sale of corporate securities by the shareholders of the transferor to those of the transferee corporation. The result of this type of transfer can be distinguished from a merger or consolidation by the continued existence of the acquired entity after the transaction has been completed. In a sale of securities, the law does

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24. Comment, *The Extension of Products Liability to Corporate Asset Transferees—An Assault on Another Citadel*, 10 LOY. L.A.L. REV. 584, 585 (1977) [hereinafter cited as *Extension of Products Liability*].

25. In a merger two or more constituent corporations combine into a single entity. The "surviving corporation" continues to exist. In a consolidation two or more constituent corporations combine to form a new consolidated corporation. All the constituent corporations cease to exist. H. HENN, *LAW OF CORPORATIONS* 713 (1970).

26. *Id.*

27. See, e.g., DEL. CODE ANN. tit. 8, §§ 103, 251 (1975); OHIO REV. CODE ANN. § 1702.41 (Page 1978).

28. See *supra* note 25.

29. See, e.g., CAL. CORP. CODE § 1107 (West 1977) (corporations formed by merger or consolidation are answerable for all the acquired or constituent corporation's liabilities whether or not the liabilities are specifically assumed); DEL. CODE ANN. tit. 8, § 259(a) (1975) ("all rights of creditors and all liens upon any property of any of said constituent corporations shall be preserved unimpaired, and all debts, liabilities, and duties of the respective constituent corporations shall thenceforth attach to said surviving or resulting corporation . . ."); OHIO REV. CODE ANN. § 1702.44(D) (Page 1978) ("all obligations, of or belonging to or due to each of the constituent corporations, shall thereafter be . . . vested in the surviving or new corporation without further act or deed . . .").

30. See, e.g., *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958).

31. See *infra* notes 54-65 and accompanying text for a more complete discussion of the de facto merger doctrine and its requirements.

not require that the transferee automatically assume the transferor's liabilities.<sup>32</sup> Since the acquired corporation continues to exist, it remains liable for strict liability judgments based on its products.<sup>33</sup> From an economic point of view, however, indirect transferee liability results because the acquiring corporation is a shareholder of the transferor.<sup>34</sup> If the resources of the acquired entity are depleted as a result of products liability suits, the market value of the corporation, and subsequently of its stock, will be reduced. The net result is that the liability of the transferee is limited by the amount and value of stock it owns in the transferor.

The strict products liability of the successor corporation in these two methods of acquisition is largely settled. The liability is assumed by law in a statutory merger<sup>35</sup> and occurs indirectly through the value of the transferor's stock in a sale of securities.<sup>36</sup> Uncertainty arises in successor strict products liability, however, in a sale of assets by the transferor corporation to the acquiring entity. The consideration for the transaction will usually be straight cash but could involve a combination of cash and securities, debentures, or other secured debt.<sup>37</sup> Traditionally, only the agreement struck by the parties (as evidenced by the contract of sale) has governed assumption of possible transferor strict products liability by the transferee in a sale of assets.<sup>38</sup>

A sale of assets presents problems in strict liability cases because there is often no clearly evident successor: only a portion of the transferor's assets may have been sold, and the seller may cease to exist after the sale. Furthermore, even if all the transferor's assets were sold to the transferee, the transferee may have refused, either expressly or implicitly, to assume the transferor's liability for improperly designed or manufactured products. In this situation, as opposed to a statutory merger or purchase of stock, it is far from clear which entity should be held responsible for strict liability judgments against the transferor.

It is important to note at this juncture that corporations seeking to acquire assets do not always have the luxury of choosing between all three of the possible methods of acquisition outlined above. Particular facts and circumstances may exclude one or more of the options. For example, the acquiring entity may not be able to secure the necessary shareholder votes for a statutory merger or to raise the necessary capital for a cash purchase. It is equally important to realize that possible liability for defective products manufactured by the transferor corporation is only one of many factors in struc-

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32. *Extension of Products Liability*, *supra* note 24, at 588.

33. *Id.*

34. *Id.*

35. See *supra* text accompanying notes 25-31.

36. See *supra* text accompanying notes 32-34.

37. See generally R. SHORT, BUSINESS MERGERS. HOW AND WHEN TO TRANSACT THEM 15-32 (1967).

A prime factor in determining the type or types of consideration to be offered is the possibility *vel non* of the transaction's being deemed a de facto merger by the courts. See *supra* notes 30-31 and accompanying text.

38. *Extension of Products Liability*, *supra* note 24, at 590-91.

turing an acquisition. Tax consequences, the extent of statutory formality required, and the desired corporate structure after the combination are all considerations of equal or greater importance.<sup>39</sup>

The assumption of strict products liability by an acquiring corporation in a sale of assets has traditionally been approached as a matter of corporate law.<sup>40</sup> The general corporate rule is that the mere sale of corporate property by one company to another does not subject the purchaser to liabilities that have not been expressly assumed.<sup>41</sup> As interpreted by courts in almost all jurisdictions, this rule has served to protect buyers of corporate assets from liability not expressly assumed, provided the transaction was made at arm's length and for adequate consideration.<sup>42</sup> There are several exceptions to the general corporate rule. Liability for obligations of the transferor will be imposed when (1) the purchaser expressly or implicitly agrees to assume the obligations, (2) the transaction amounts to a consolidation or merger of the two corporations (including a de facto merger), (3) the purchasing corporation is deemed merely a continuation of the selling corporation, or (4) the transaction is a fraudulent one, its real purpose being to escape liability for unassumed obligations.<sup>43</sup>

The corporate law rule evolved primarily to satisfy known creditors of the transferor at the time of merger or sale.<sup>44</sup> Usually, this kind of liability is easily handled by the parties. Either the seller retains the commitments after the sale takes place, or the buyer assumes them, probably cutting his price to compensate for the additional future expense. In this manner the rule promotes the free exchange of corporate assets by enabling the parties to strike their own bargain on assumption of liability.<sup>45</sup> The corporate rule ignores, however, the contingent claims of strict products liability plaintiffs.<sup>46</sup>

### III. THE TENSION BETWEEN TORT AND CORPORATE POLICY

On first impression the corporate law rule holding transferees liable only for obligations they expressly assume is felt equally by tort victims and creditors. Most claims of creditors, however, can be accurately ascertained at the time of the acquisition;<sup>47</sup> the future claims of tort victims may not. In fact, the

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39. See generally R. SHORT, *BUSINESS MERGERS. HOW AND WHEN TO TRANSACT THEM* 33-47 (1967).

40. Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142, 142 (1980).

41. *Shane v. Hobam, Inc.*, 332 F. Supp. 526, 527 (E.D. Pa. 1971).

42. Juenger & Schulman, *Assets Sales and Products Liability*, 22 WAYNE L. REV. 41, 45 (1975).

43. *Shane v. Hobam, Inc.*, 332 F. Supp. 526, 527-28 (E.D. Pa. 1971).

44. Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86, 91 (1975).

45. *Id.*

46. See *infra* text accompanying notes 47-53.

47. Some contingent liabilities may in fact be uncertain at the time of the transfer but can nonetheless be accurately estimated by the parties. One example is liability under express warranty, which can be easily determined on the basis of the manufacturer's past experience. Warranties also, by their terms, have limited lives. This factor adds an additional element of certainty to the estimation. In most states statutes of limitation do not begin to run on products liability actions until the cause of action has accrued. 1 PROD. LIAB. REP. (CCH) ¶ 3420 (1981).

cause of action may not arise until years later, long after the corporation that manufactured the defective product has dissolved, liquidated, or become insolvent. In this situation the corporate rule may "seriously prejudice a products liability claimant in his search for a viable defendant."<sup>48</sup>

Ever since *Greenman v. Yuba Power Products, Inc.*,<sup>49</sup> in which the California Supreme Court abolished the requirement in strict liability actions of a warranty running from manufacturers to users of their products, courts have been confronted by conflicting policy considerations regarding the strict products liability of successor corporations in asset sales. While the corporate rule promotes commerce and certainty, the tort rule dictates the opposite result by compensating innocent victims who are unexpectedly injured by dangerously defective products. At first courts almost exclusively favored the application of corporate law over the law of tort. Plaintiffs stood little chance of collecting strict liability judgments from manufacturers that had liquidated their assets unless the transferee specifically assumed liability.<sup>50</sup> While the judicial response to a strict products liability claim against an acquired corporation would almost certainly have been "no" at the time of *Greenman*, courts have begun to acknowledge the legitimacy of such a claim in recent years. The reply has now changed to "perhaps."<sup>51</sup>

This shift in judicial attitude has manifested itself in two ways. Some courts have begun to construe more liberally the exceptions to the traditional corporate rule, especially in the context of the de facto merger.<sup>52</sup> Others have abandoned the corporate rule completely and have treated the strict products liability of successor corporations exclusively as a tort problem.<sup>53</sup>

## A. Expanding the Exceptions

### 1. The De Facto Merger Theory

If a court considers a sale of corporate assets to be so similar to a merger that it warrants subsection to the same procedural requirements and legal

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48. *Extension of Products Liability*, *supra* note 24, at 592-93. See, e.g., *Tucker v. Paxson Mach. Co.*, 645 F.2d 620 (8th Cir. 1981) (suit involving a rubber calendar machine that malfunctioned 58 years after it was manufactured).

49. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963). In *Greenman* the court held that the plaintiff was not required to establish an express warranty with the manufacturer to recover on a strict products liability theory. *Id.* at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700 (1963).

50. See, e.g., *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817 (D. Colo. 1968); *Schwartz v. McGraw Edison Co.*, 14 Cal. App. 3d 767, 92 Cal. Rptr. 776 (Ct. App. 1971); *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 264 A.2d 98 (Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (Super. Ct. App. Div. 1972).

51. Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142, 142 (1980).

52. See *Cyr v. B. Offen & Co.*, 501 F.2d 1145 (1st Cir. 1974); *Knapp v. North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974); *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797 (D.C. Mich. 1974).

53. See *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977); *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976). The fraud exception will not be discussed in detail below because of its accepted common-law nature and the lack of any significant expansion of the exception by the courts. The express or implied assumption of liability by a successor will not be analyzed in detail for similar reasons.

consequences as a statutory merger, the court will recognize a de facto merger.<sup>54</sup> In effect, the acquiring corporation is held liable for the torts of the transferor through state merger law.<sup>55</sup> The court in *Shannon v. Samuel Langston Co.*<sup>56</sup> summarized the characteristics that distinguish a de facto merger from an ordinary purchase and sale of assets:

- (1) There is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.
- (2) There is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.
- (3) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.
- (4) The purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.<sup>57</sup>

In *Knapp v. North American Rockwell Corp.*<sup>58</sup> Knapp, an employee of Mrs. Smith's Pie Company, was injured when his hand was caught in a machine known as a "packomatic," designed and manufactured by Textile Machine Works Inc. (TMW). TMW, about one year prior to the accident, had traded substantially all its assets for North American Rockwell securities. Although certain liabilities were assumed by Rockwell, the decision was based on the premise that the plaintiff's claim had not been assumed.<sup>59</sup> The injury to Knapp occurred after the closing date of the purchase transaction, but four and one-half months prior to the dissolution of TMW, which took place 18 months after the closing date.<sup>60</sup> Although these circumstances technically precluded application of the de facto merger doctrine because the transferor existed at the time of the injury,<sup>61</sup> the court was willing to stretch the doctrine and allowed the plaintiff to recover. "Denying Knapp the right to sue Rockwell because of the barren continuation of TMW after the exchange with Rockwell would allow a formality to defeat Knapp's recovery."<sup>62</sup>

The *Knapp* court struggled to distinguish the case at bar from cases with

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54. *Extension of Products Liability*, *supra* note 24, at 598.

55. *Id.* at 586.

56. 379 F. Supp. 797 (W.D. Mich. 1974).

57. *Id.* at 801.

58. 506 F.2d 361 (3d Cir. 1974).

59. *Id.* at 362-63.

60. *Id.* at 363.

61. According to the court in *Shannon v. Samuel Langston Co.*, this is the third characteristic that distinguishes a de facto merger from an ordinary purchase and sale of assets. See *supra* text accompanying note 57.

62. *Knapp v. North American Rockwell Corp.*, 506 F.2d 361, 368-69 (3d Cir. 1974). The decision has provoked at least one state legislature to take steps to limit the de facto merger to successor tort liability. Texas has enacted legislation stating specifically that a disposition of all or substantially all the property and assets of a corporation requiring consent of its shareholders will *not* be considered a statutory merger or consolidation and will not make the acquiring corporation liable for obligations it did not expressly assume. TEX. BUS. CORP. ACT ANN. art. 5.10B (Vernon 1980).



similar fact patterns that had been decided against products liability plaintiffs.<sup>63</sup> It stressed the "insubstantiality of the continued existence of TMW," including the brevity of its postmerger life; contractual requirements that TMW be dissolved as soon as possible, which prohibited TMW from engaging in normal business transactions; and the character of the assets TMW controlled after the sale. The court conceded that each of these factors was present in the cases it was seeking to distinguish, but declared *Knapp* "unique in combining all of these elements."<sup>64</sup> While the decision was clearly based on corporate law, the policy behind the result, as described by Judge Adams, had a distinctly tort law flavor: "[N]either Knapp nor Rockwell was ever in a position to prevent the occurrence of the injury . . . as neither manufactured the defective device. As between the two parties, however, Rockwell is better able to spread the burden of the loss."<sup>65</sup>

*Knapp*, then, is an illustration of how a court can circumvent the general corporate rule of nonliability and invoke tort policy by slightly bending the requirements for finding a de facto merger, thus subjecting the successor corporation to liability for the improperly manufactured products of its predecessor through state statutory merger law. In *Knapp* the requirement that TMW liquidate as soon as possible after the sale did not prevent a finding of de facto merger, and the plaintiff was allowed to recover for an injury caused by the transferor's product.

## 2. The Continuation Theory

Another generally recognized exception to the corporate rule holds transferees responsible for the liabilities of transferors when the acquiring corporation is merely a continuation of the entity acquired.<sup>66</sup> This exception is employed by courts less frequently than the de facto merger exception, possibly because there is no judicial agreement on what circumstances require an application of the continuation doctrine.<sup>67</sup> Courts have found a continuation after considering a number of elements, both separately and in combination. These include whether the manufacturing operations remained unchanged after the transfer, whether there was a continuation of product line, product name, personnel, or general business operations, and whether the successor has officers and directors in common with its predecessor.<sup>68</sup>

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63. See, e.g., *Bazan v. Kux Mach. Co.*, 358 F. Supp. 1250 (E.D. Wis. 1973); *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 264 A.2d 98 (Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (Super Ct. App. Div. 1972). See also *infra* notes 68-70.

64. *Knapp v. North American Rockwell Corp.*, 506 F.2d 361, 367 (3d Cir. 1974).

65. *Id.* at 369-70.

66. See, e.g., *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976).

67. Comment, *Successor Liability in Corporate Acquisition—An Examination of Attempts to Limit the Use of the De Facto Merger Doctrine*, 46 J. AIR L. & COM. 483, 497 (1981). The continuity exception, however, is more popular with the courts than the fraud or assumption of liability exceptions. *Id.*

68. See generally *Lopata v. Bemis Co.*, 406 F. Supp. 521 (E.D. Pa. 1975); *Comstock v. Great Lakes Distrib. Co.*, 209 Kan. 306, 496 P.2d 1308 (1972); *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 264 A.2d 98 (Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (Super. Ct. App. Div. 1972).

The beginnings of the continuation exception reveal a rather strict reading of "continuation." For liability to attach to a transferee, the new corporation needed to be no less than a "new coat" for its predecessor.<sup>69</sup> Consequently, most or all the elements mentioned above had to be present before a court would find a continuation. A number of modern courts have continued to construe the exception in this manner, applying it only to simple changes in the form of a business entity (as in the case of a recapitalization or a change in corporate name or place of incorporation).<sup>70</sup> Because of the variety of circumstances to be considered in making a continuation determination, however, the exception has also proved to be a convenient vehicle for courts bent on imposing strict products liability on successor corporations without abandoning the sanctuary of traditional corporate rules.

In *Cyr v. B. Offen Co.*,<sup>71</sup> a 1974 case occasioned by a defective printing press, the continuity exception was applied to a sale of assets by a sole proprietor. Seventy percent of the acquiring corporation was owned by former employees of the proprietor; the remaining shares were held by an "outside financier."<sup>72</sup> The contract of sale provided that the buyer would assume certain liabilities of the seller, but tort liability was specifically excluded.<sup>73</sup>

The *Cyr* court held that at least two of four reasons cited by the plaintiff for imposing strict liability applied to successors in ownership as well as original manufacturers: first, the manufacturer [or the successor], compared with the consumer, is better able to bear the cost of injuries caused by defective products; and second, the manufacturer [or the successor] is the party best able to prevent such suits because it has control over product design and quality.<sup>74</sup> More significantly, however, the court stressed that holding successor corporations liable for torts of acquired entities is a fair, reasonable, and socially desirable policy:

The very existence of strict liability for manufacturers implies a basic judgment that the hazards of predicting and insuring for risk from defective products are better borne by the manufacturer than by the consumer. The manufacturer's successor, carrying over the experience and expertise of the manufacturer, is likewise in a better position than the consumer to gauge the risks and the cost of meeting them. The successor knows the product, is as able to calculate the risk of defects

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69. *Bergman & Lefkow Ins. Agency v. Flash Cab Co.*, 110 Ill. App. 2d 415, 431, 249 N.E.2d 729, 737 (1969).

70. See *Forest Laboratories v. Pillsbury Co.*, 452 F.2d 621 (7th Cir. 1971); *Lopata v. Bemis Co.*, 383 F. Supp. 342 (E.D. Pa. 1974); *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817 (D. Colo. 1968); *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 264 A.2d 98 (Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (Super. Ct. App. Div. 1972).

71. 501 F.2d 1145 (1st Cir. 1974).

72. *Id.* at 1151.

73. *Id.*

74. *Id.* at 1154. The two other reasons posed by the plaintiff for imposing strict liability, which the *Cyr* court felt did not apply to successor corporations in a continuation or any other context, are as follows: First, it is the manufacturer that has launched the product into the channels of trade; and second, it is the manufacturer that has violated the representation of safety implicit in the product's presence in the stream of commerce. *Id.*

as the predecessor, is in [a] position to insure therefor and reflect such cost in sale negotiations, and is the only entity capable of improving the quality of the product.<sup>75</sup>

*Cyr* represents an expansion of the continuity exception because the court, for the policy reasons above, tailored the elements considered to the facts of the case in finding continuity. In the words of Judge Coffin, "[W]here tort liability is concerned, we should look to factors relevant to the specific claim and not be bound by factors that control where other debts and liabilities are concerned."<sup>76</sup> Thus, *Cyr* was allowed to prevail even though successor B. Offen & Company was characterized by an imperfect transfer of ownership due to the outside financier's thirty percent interest and by a lack of continuity of management. Under the usual strict reading of the continuity exception,<sup>77</sup> these factors might have precluded recovery.

*B. Breaking Away From Corporate Law—Ray v. Alad Corp. and Turner v. Bituminous Casualty Co.*

The vast majority of cases dealing with strict products liability claims against successor corporations have applied the traditional corporate rule of nonliability, finding in the plaintiff's favor only if one of the four exceptions to this rule applied.<sup>78</sup> *Ray v. Alad Corp.*<sup>79</sup> was the first case to break clearly with this precedent, completely discarding the corporate law and its exceptions in favor of a tort-based analysis.<sup>80</sup> Plaintiff Ray was injured while using a defective ladder manufactured by Alad I, a family owned corporation with an excellent reputation in the ladder industry. Less than one year before the mishap, Alad I was acquired by defendant Alad II in an assets-for-stock transaction. Alad II acquired Alad I's plant, inventory, trade name, and good will and continued to manufacture the same line of ladders under the Alad name. The successor used the same equipment, designs, and personnel as the transferor and solicited Alad I's customers with the same sales representatives, giving no outward sign that the corporation had changed ownership.<sup>81</sup>

The Supreme Court of California specifically rejected Ray's contentions that the transaction constituted a de facto merger<sup>82</sup> and that Alad II was a continuation of Alad I.<sup>83</sup> The two exceptions were construed rather strictly by the court; it refused to expand them as was done in *Knapp v. North American*

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75. *Id.*

76. *Id.* at 1153.

77. See *supra* text accompanying notes 66-70.

78. See *supra* text accompanying notes 40-43.

79. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

80. See also *Ramirez v. Amstead*, 171 N.J. Super. 261, 408 A.2d 818 (Super. Ct. App. Div. 1979), and *Rawlings v. D.M. Oliver Inc.*, 97 Cal. App. 3d 888, 159 Cal. Rptr. 119 (Ct. App. 1979).

81. *Ray v. Alad Corp.*, 19 Cal. 3d 22, 27-28, 560 P.2d 3, 5-6, 136 Cal. Rptr. 574, 577 (1977).

82. *Id.* at 28, 560 P.2d at 7, 136 Cal. Rptr. at 578.

83. *Id.* at 29-30, 560 P.2d at 7-8, 136 Cal. Rptr. at 578-79.

*Rockwell Corp.*<sup>84</sup> and *Cyr v. B. Offen & Co.*<sup>85</sup> because it thought that to do so would set an unfavorable precedent for courts assessing liabilities to creditors in general outside of a strict products liability context.<sup>86</sup> Strict liability, according to the *Ray* court, is a unique problem of a successor corporation and therefore deserves special consideration.<sup>87</sup>

While the court did not furnish a clear holding, it extended this special consideration either by (1) repudiating corporate law completely in successor corporation strict liability cases, thus treating the problem strictly as a matter of tort,<sup>88</sup> or by (2) creating a new exception to the corporate rule: the "product line" exception.<sup>89</sup> Regardless of how the holding is viewed,<sup>90</sup> the *Ray* decision marked an unprecedented departure from usual corporate law concepts and served notice to successor corporations that the trend favoring strict liability for products manufactured by their predecessors was continuing. The court's justification for the holding indicated that the tort policies of fairness and risk spreading were of great importance, contrary to the corporate law emphasis on certainty and express assumption of liability. The three reasons given by Judge Wright for imposing liability on Alad II were:

(1) [T]he virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business, (2) the successor's ability to assume the original manufacturer's risk-spreading rule, and (3) the fairness of requiring the successor to assume responsibility for defective products that was a burden necessarily attached to the original manufacturer's good will being enjoyed by the successor in the continued operation of the business.<sup>91</sup>

*Turner v. Bituminous Casualty Co.*<sup>92</sup> most accurately reflects both the willingness of courts to hold successor corporations liable for defectively manufactured products produced by their predecessors and the judicial confusion regarding which theory to use in doing so. Turner was injured on July 26, 1979, by a power press manufactured by T.W. & C.B. Sheridan Company (Old Sheridan). The machine was manufactured in 1903 and purchased secondhand by the Seaman Manufacturing Company, Turner's employer, in 1968. In 1964 Old Sheridan was purchased for cash by Harris Intertype Cor-

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84. 506 F.2d 361 (3d Cir. 1974). See *supra* notes 58-65 and accompanying text.

85. 501 F.2d 1145 (1st Cir. 1974). See *supra* notes 71-77 and accompanying text.

86. *Ray v. Alad Corp.*, 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977).

87. *Id.*

88. See Comment, *Successor Liability in Corporate Acquisition—An Examination of Attempts to Limit the Use of the De Facto Merger Doctrine*, 46 J. AIR L. & COM. 483, 512-13 (1981); Comment, *Extension of Strict Tort Liability to Successor Corporations*, 61 MARQ. L. REV. 595, 608-09 (1978); *Extension of Products Liability*, *supra* note 24, at 510-11; 30 VAND. L. REV. 238, 252-53 (1977).

89. See Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142, 148-49 (1980). See also *Tucker v. Paxson Mach. Co.*, 645 F.2d 620 (8th Cir. 1981); *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 441 (7th Cir. 1977); *Domine v. Fulton Iron Works*, 76 Ill. App. 3d 253, 256, 395 N.E.2d 19, 22 (1979).

90. Justice Wright does nothing to resolve this conflict in the course of his opinion in *Ray*—he refers to the decision as both a "special departure" from the corporate rule and a "special exception" to that rule. *Ray v. Alad Corp.*, 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977).

91. *Id.* at 31, 560 P.2d at 8-9, 136 Cal. Rptr. at 580.

92. 397 Mich. 406, 244 N.W.2d 873 (1976).

poration through a newly formed subsidiary, New Sheridan. Old Sheridan dissolved five days later. On July 24, 1968, New Sheridan formally merged with Harris, becoming the Sheridan Division of Harris Intertype Corporation.<sup>93</sup> This convoluted set of facts caused the trial court to hold that Harris and New Sheridan were "not responsible for a product to which they are corporate strangers in the manufacture, sale and distribution thereof, and for which they neither in fact nor law assumed legal liability."<sup>94</sup>

The Supreme Court of Michigan, however, took a different view: "[T]his is a products liability case first and foremost."<sup>95</sup> It cited language in *Ray* indicating that a break with corporate law is proper when the strict liability of successor corporations is at issue<sup>96</sup> and apparently endorsed this interpretation.<sup>97</sup> Despite the strong language above indicating that tort law ought to control, the court in *Turner* curiously elected to stay within the corporate law framework when fashioning its holding. The result was a four-fold test that in effect eliminated continuity of ownership as a requirement for satisfaction of the continuation exception.<sup>98</sup> Exactly why the court chose to feint in the direction of a purely tort analysis, only to return to traditional corporate law, is unclear. Perhaps it thought the decision would be better accepted by courts of appeal and the public if it rested on a corporate foundation.

The state of the law regarding the application of strict products liability to successor corporations, then, is complex. The policies behind the corporate and tort rules are dissonant and perhaps irreconcilable: corporate law protects purchasers of assets from unassumed liability, while tort law compensates unsuspecting victims of dangerous defects that defy detection until after injury has been sustained. The courts appear to be sympathetic to the strict liability plaintiff yet reluctant to venture beyond the traditional corporate rule and its exceptions.

#### IV. A WORKABLE SOLUTION

Presently the victim of a dangerously defective product manufactured by a corporation that has since transferred its assets to another entity has two

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93. *Id.* at 411-13, 244 N.W.2d at 875-76.

94. *Id.* at 413, 244 N.W.2d at 876.

95. *Id.* at 416, 244 N.W.2d at 877.

96. *Ray* has been interpreted both as creating a break with corporate law and as merely adding a new "product line" exception to the traditional corporate law rule. See *supra* notes 88-91 and accompanying text.

97. *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 423-24, 244 N.W.2d 873, 880 (1976).

98. *Id.* at 430, 244 N.W.2d at 883-84. The *Turner* test, as applied by the court to the facts of the case, is as follows:

- (1) There was basic continuity of the enterprise of the seller corporation, including, apparently, a retention of key personnel, assets, general business operations, and even the Sheridan name.
- (2) The seller corporation ceased ordinary business operations, liquidated, and dissolved soon after distribution of consideration received from the buying corporation.
- (3) The purchasing corporation assumed those liabilities and obligations of the seller ordinarily necessary for the continuation of the normal business operations of the seller corporation.
- (4) The purchasing corporation held itself out to the world as the effective continuation of the seller corporation.

possible sources from which to seek relief. First, suit can be brought against the original manufacturer, provided the proceeds of the sale are still available and sufficient to satisfy the claim.<sup>99</sup> This alternative is of little value if the offending company has liquidated or dissolved before the cause of action is manifest.<sup>100</sup> Liquidation and dissolution statutes require the satisfaction of known liabilities before distribution of the proceeds among shareholders, but do not address "contingent" products liability claims arising after the dissolution and distribution.<sup>101</sup> Second, the victim can bring suit against the successor corporation, either alleging that one of the exceptions to the general corporate rule of nonliability applies, or asking that his claim be considered solely in tort, entirely apart from corporate law. The results to be expected from this course of action are unpredictable, as indicated above.<sup>102</sup>

The strict liability plaintiff is hampered in both instances by the general rule of nonliability imposed by corporate law—a rule not originally intended to cover strict liability situations at all, but geared toward creditor protection.<sup>103</sup> While the rule functions satisfactorily when the creditors are known at the time of the transfer, it becomes strained when applied to "contingent" tort liability and actually operates in reverse by denying claims against corporations instead of protecting them. Thus, it appears Justice Wright was correct when he concluded in *Ray* that some kind of special rule is necessary to deal with strict liability suits against successor corporations.<sup>104</sup>

A sensible solution to the problem would take into account both the social and individual need for products liability plaintiffs to be compensated and the business need to determine with reasonable certainty the liabilities that will be assumed in a transfer of corporate assets. The fairest and most

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99. *Extension of Products Liability*, *supra* note 24, at 593-94.

100. *Id.* The "trust fund doctrine," first advanced by Justice Story in *Wood v. Dummer*, 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944), is a long-standing though unpredictable and cumbersome method of dealing with this problem. According to *Wood*, the capital stock of a corporation is a pledge or trust fund for creditors. After the corporation dissolves, the proceeds from the dissolution continue to be held in trust by the former shareholders and may continue to be reached by creditors of the corporation if required by the principles of equity. This liability is limited to the value of the stock held; no further personal liability is imputed. *Id.* at 436-37. For a discussion of the trust fund doctrine, see generally Norton, *Relationship of Shareholders to Corporate Creditors upon Dissolution: Nature and Implications of the "Trust Fund" Doctrine of Corporate Assets*, 30 BUS. LAW. 1061 (1975).

Another suggested remedy is to require escrow accounts or indemnity agreements to satisfy contingent liabilities of liquidated corporations. See Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A.L. REV. 738, 807 n.262 (1976). The problems with this approach, however, are many. Because products liability judgments vary tremendously in amount, it is difficult to determine the total value of the assets that should be placed in escrow for this purpose or the amount of liability insurance coverage that the successor corporation should obtain. Further, it is difficult to estimate how long these arrangements should be continued after the product is manufactured.

101. *Extension of Products Liability*, *supra* note 24, at 593-94. At least one state, California, has decreed by statute that a dissolved corporation continues to exist for the purpose of defending lawsuits and discharging obligations. CAL. CORP. CODE ANN. § 2010 (West 1977). This statute has never been used successfully to assert a strict products liability claim. *Extension of Products Liability*, *supra* note 24, at 594. Even if such a plaintiff were to prevail, however, it is by no means certain that the directors involved could satisfy a judgment. *Id.*

102. See generally *supra* text accompanying notes 47-98.

103. Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86, 91 (1975).

104. *Ray v. Alad Corp.*, 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977).

predictable manner in which to accomplish these objectives is to presume the successor corporation to be liable for defective products manufactured by its predecessor. In other words, after the plaintiff has proved that the strict liability claim is a valid one and that the defendant is in possession of the assets that produced the defective product, a *prima facie* case of successor liability is established and a presumption of successor liability raised. To rebut this presumption, the successor will have to show that it is not benefitting through the reputation or personnel of the transferor, or from the assets acquired. The best indicator of this kind of benefit appears to be a broad inquiry into whether the successor is a continuation of the corporation acquired.

An examination of this proposition must start with the law of strict liability and its application to an original manufacturer of defective products. The law of tort is concerned, according to Prosser, "with the allocation of losses arising out of human activities".<sup>105</sup> The purpose of tort law is to allocate these losses in a manner most advantageous to society as a whole and to compensate one party for injury sustained as a result of the conduct of another.<sup>106</sup> According to the strict products liability theory, losses resulting from injuries caused by defectively manufactured products are properly placed on the manufacturer of the product.<sup>107</sup>

If the corporation that originally manufactured the defective product sells its assets to another entity, however, present law completely eliminates the strict liability cause of action with respect to the successor.<sup>108</sup> In fact, present law *presumes the successor not to be liable* unless one of the four exceptions to the general rule is satisfied.<sup>109</sup> To determine if this substantial shift of presumed liability after a sale of assets is justified,<sup>110</sup> it is necessary to consider what effect that shift has on the policy reasons behind imposing strict liability on the original manufacturer.

The court in *Cyr. v. B. Offen & Co.*,<sup>111</sup> when confronted with four reasons provided by the plaintiff for imposing strict liability on an original man-

105. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 6 (4th ed. 1971).

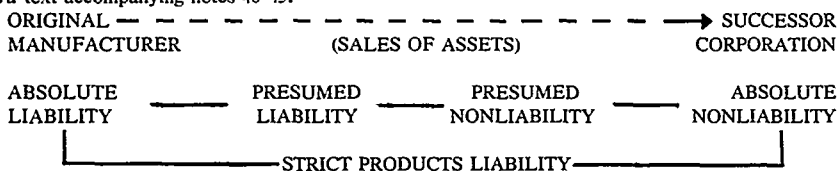
106. *Id.*

107. RESTATEMENT (SECOND) OF TORTS § 402A comment c (1965).

108. See *supra* notes 40-45 and accompanying text.

109. *Id.*

110. The scope of the shift of presumed liability can be illustrated by a continuum showing different levels of presumption or nonpresumption of strict products liability. The original manufacturer of a defective product is absolutely liable if the product injures someone. If the same manufacturer sells his assets, the transferee, under the general corporate law rule, is presumed not to be strictly liable for the same defective product. See *supra* text accompanying notes 40-45.



111. 501 F.2d 1145 (1st Cir. 1974).

ufacturer, concluded that while two of these reasons did not apply to a corporate successor, the other two clearly did.<sup>112</sup> This analysis is symbolic of the inquiry as a whole—there are many reasons for treating successor corporations differently from their predecessors about strict products liability, and as many for treating them in a similar fashion. Regardless of which entity owns the assets that were used to manufacture the defective product, there remains an injured user who is unable to protect himself or herself from the dangerous instrumentality. Compared with the user, the successor is still a better vehicle for spreading the risk of that injury because of its financial superiority. Further, if the successor continues to produce the same or a similar product, or utilizes the same directors, management, or other personnel, it continues to benefit from past good will accumulated by the transferor. On the other hand, the transferee was not responsible for placing the defective product in commerce and did not profit from doing so, except perhaps indirectly through the good will acquired from the transferor.<sup>113</sup>

Because a balancing of the equities results in a virtual stalemate, the shift from the absolute liability of a manufacturer to a presumption of nonliability based solely on a transfer of corporate assets is too great. A better rule would be to adopt a middle course and shift from absolute transferee liability to *presumed* absolute liability on the part of the transferee. The technical effect of such a presumption of law would be that in the absence of evidence to the contrary a judge or jury would be obligated to find for the plaintiff.<sup>114</sup>

To rebut the presumption of absolute liability, the successor corporation would have to show the inequity of placing that responsibility upon it. The presence or absence of a broadly construed continuation of the transferor is the appropriate vehicle to accomplish this because it covers all the circumstances in which successors are asked to assume that liability under present law, yet it extends the law far enough to provide certainty in what is now an unpredictable situation—liability pursuant to a sale of assets.<sup>115</sup> The burden should be one of persuasion by a preponderance of the evidence; the mere presentation of evidence will not be enough.<sup>116</sup> This will not be an easy burden to carry, nor is it meant to be. It should be a rare case when the successor acquires so little benefit from a purchase of assets that it does not merit being held liable for defective products manufactured by the transferor.<sup>117</sup>

A broadly construed continuation analysis<sup>118</sup> should include any factor in

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112. See *supra* note 74 and accompanying text.

113. For a more complete discussion of the policy considerations behind strict products liability see *supra* notes 14–17 and accompanying text.

114. IX J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2490 (1981).

115. A broadly construed continuation rule would include both statutory and de facto merger situations. Both types of combinations are viewed as exceptions to the general corporate rule of nonliability precisely because the resultant continuity between the merging corporations is great. The other two exceptions, which involve express or implied assumptions of liability and fraud, would be unchanged by a broad continuation approach.

116. IX J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2498 (1981).

117. See *infra* text accompanying notes 141–42.

118. As opposed to a strict construction of continuation requiring that the successor be no more than a “new coat” for the acquired entity. See *supra* text accompanying notes 69–70.



the transfer that bears on the reasonableness of forcing a successor corporation to assume strict liability claims against its predecessor. A comprehensive but not exhaustive list would include (1) liquidation or dissolution of the seller corporation, (2) continuity of product line, (3) continuity of general business operations, (4) continuity of management and personnel, (5) adequacy of consideration, (6) existence of an express or implied agreement to assume liability stemming from defective products or otherwise, and (7) sale of substantially all the transferor's assets, or of substantially all a certain product line. The relative weight of each of these and other factors would depend heavily on the facts of the particular case, but no single consideration should control; one may be enough in some circumstances, three or four may not suffice in others.

Note that this approach would not change the holdings of cases such as *Knapp v. North American Rockwell Corp.*,<sup>119</sup> *Cyr v. B. Offen & Co.*,<sup>120</sup> *Ray v. Alad Corp.*,<sup>121</sup> or *Turner v. Bituminous Casualty Co.*<sup>122</sup> In all four of these cases the presumption of successor liability would impose liability. However, the new approach would achieve these results through a common method of analysis; contortion of the general corporate rule and its exceptions would no longer be necessary to impose liability on successor corporations. The measure of certainty provided by a common analysis will benefit both successor corporations and users of products by allowing them to better predict future liability and to plan accordingly.

The approach to successor strict products liability discussed above may be summarized as follows: Plaintiff (*P*) is injured operating a machine produced by a corporation (*C*) that, before the injury to *P* occurred, sold its assets to a successor corporation (*S*). *P* must first satisfy the basic requirements of a strict products liability action by showing (1) that an injury was caused by the allegedly defective product, (2) that the product was in fact defective and thus unreasonably unsafe, and (3) that the product was defective when it left the hands of the defendant.<sup>123</sup> *P* must also show that the assets of *C* have been purchased by *S*. If *P* can establish all the above, *S* will be presumed to be liable to *P* on a strict tort theory as the successor of *C*.

To rebut the presumption above and escape liability, *S* will have to show that it is not a continuation of *C* and is not benefitting in any substantial manner from the good will established by *C* while *C* was in business. *S* will base its argument on the seven factors above and on any other considerations it deems relevant. This will be a very heavy burden for *S* to bear, and the result will probably favor *P* unless *S* is using the assets to produce a completely different kind of product and has clearly disassociated itself from *C* in almost every other possible manner.<sup>124</sup>

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119. 506 F.2d 361 (3d Cir. 1974). See *supra* text accompanying notes 58-65.

120. 501 F.2d 1145 (1st Cir. 1974). See *supra* text accompanying notes 71-77.

121. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977). See *supra* text accompanying notes 78-91.

122. 397 Mich. 406, 244 N.W.2d 873 (1976). See *supra* text accompanying notes 92-98.

123. See *supra* note 19 and accompanying text.

124. *S*, at the time of the acquisition, may have structured the transaction so that *C* is actually bearing the burden of *P*'s injury. See *infra* text accompanying notes 126-39.

## V. THE CONSEQUENCES

An analysis that presumes successor corporations strictly liable for defective products produced by predecessors in interest would be a significant departure from traditional practice. Accompanying this departure is an uncertainty about the consequences. The major fear is an economic one: if purchasers of corporate assets are required to assume responsibility for strict liability claims against products previously manufactured by the former owner of the assets, the purchaser is in effect being forced to pay consideration in excess of fair market value. As a result, acquisitions will be discouraged.<sup>125</sup> Sellers of corporate assets may not be able to find buyers and consequently may be forced to dispose of the assets individually, sacrificing the good will that would attach to their sale as a unit. Therefore, the argument goes, destroying the corporate rule of successor nonliability would result in terminating the seller's business "in a manner that neither optimizes the use of resources nor, because it appears unfair and unworkable to impose liability on a buyer of individual assets, protects products liability claimants."<sup>126</sup>

There is little doubt that the analysis in part four above, which almost certainly allows strict liability suits to be brought against corporate successors, will make negotiations between corporate buyers and sellers more complex. One of the parties will have to bear the cost of possible products liability suits based on goods manufactured by the seller before the sale. Once buyers are aware that they face liability in this manner, however, they can fashion ways to protect themselves against it that would in effect force the seller to absorb the cost. This result is desirable both from a tort policy point of view, because the actual manufacturer of the defective product pays for the harm caused by the product, and from a corporate law perspective, because it facilitates the free transfer of corporate assets. It is also intuitively fair to place the loss, if possible, on the corporation that manufactured the product causing the injury.

The most straightforward manner in which the transferee can shift the cost of products liability judgments back to the transferor is simply to pay less for the assets acquired. Elementary economics dictates that groups of assets that may subject the purchaser to contingent claims against them do not have the same value as assets acquired free of those claims. Exactly how much less the assets are worth would be determined primarily by the type of goods the assets were used to produce. An automobile assembly line, for example, manufactures an extremely complex product that conceivably could lead to a large number of very expensive strict products liability judgments. On the other hand, the product of a bookbinding factory would expose the purchaser to less products liability litigation, with a lower average award per suit. There are a number of variations on this lower-price-for-assets theme. The trans-

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125. Juenger & Schulman, *Assets Sales and Products Liability*, 22 WAYNE L. REV. 39, 55-56 (1975).

126. *Id.* at 57.

feror can be required to establish an escrow account to service products liability claims,<sup>127</sup> former shareholders of the transferor can be required to execute a personal indemnity agreement,<sup>128</sup> or the selling corporation can be required to obtain or continue products liability insurance.<sup>129</sup>

Each of these protective devices has its particular problems. An escrow account is unwieldy because it is uncertain how long the fund should continue to exist and how large it needs to be to satisfy the claims that may be made against it. The kind of product the assets were used to manufacture and the product's capacity to injure will provide some guidance in this regard, but the accuracy of even the most educated guess would be inherently suspect.<sup>130</sup> Further, in situations in which the seller wants to liquidate and dissolve after the transfer, there may be no funds to put in escrow after current liabilities to creditors and shareholders have been satisfied.<sup>131</sup>

Although it may be possible for the successor to contract with shareholders of the transferor to indemnify it for subsequent strict liability claims, this would not be an easy concession to exact. Limited liability is one of the most attractive features of the corporate form, and it is doubtful that many shareholders would agree to personal liability for future judgments against a liquidated corporation. Legislation requiring assumption of personal liability could be proposed, but its passage might seriously impair the market value of corporate securities. Consequently, a personal shareholder indemnity contract would probably be feasible only if the seller is a close corporation with a small number of willing shareholders.<sup>132</sup>

Liability insurance generally is available to original manufacturers to protect them from strict liability judgments against their products.<sup>133</sup> Usually a product-caused loss occurring outside of the policy period is covered by the employer's products liability insurance if it was sold during the policy tenure. However, this rule may be circumvented if the terms of the policy so state.<sup>134</sup> Given the growing tendency of courts to saddle successor corporations with the tort liabilities of their predecessors, it would be sound policy for states to require manufacturers to carry products liability insurance that will protect

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127. *Extension of Products Liability*, *supra* note 24, at 611 n.149.

128. *Id.*

129. *Id.* This alternative was suggested by the court in *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797, 802 (W.D. Mich. 1974).

130. This problem occurs in a different form when the successor pays a lower price for a group of assets in anticipation of possible strict products liability judgments: the lower price may not be low enough to cover the amount needed to satisfy these judgments. With an escrow account, however, a new problem arises: if the assets placed in escrow are depleted, on whom does the risk of injury due to defective products fall? The answer is beyond the scope of this Comment but deserves careful consideration by the parties to such agreements.

131. *Extension of Products Liability*, *supra* note 24, at 611 n.149.

132. The successor could always hope that the courts would apply the trust fund doctrine of *Wood v. Dummer*, 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,994), and reach the former shareholders of the transferor without any kind of agreement. It is doubtful, however, that this step would be taken when a more viable defendant exists—and in most cases, that defendant would be the successor itself. See also *supra* note 100 for a more complete explanation of the trust fund doctrine.

133. 11 COUCH ON INSURANCE § 44:380 (2d ed. 1963).

134. *Id.* at § 44:385.

users of their products for the life of the product. Otherwise, a transfer of coverage can be arranged between buyer and seller.<sup>135</sup>

As a last resort, the buyer could procure liability insurance himself. However, this task may not be as simple as it sounds: some kind of past insurance dealings with the carrier are often required, and the desired coverage may be available at a reasonable cost only as part of a "package" deal.<sup>136</sup> Furthermore, unless the successor can pass the price of the insurance back to the original manufacturer by deducting it from the purchase price of the assets, the transferee must bear the entire burden of obtaining the coverage. Sound policy and considerations of fairness would place the cost of insurance on the original manufacturer if possible.<sup>137</sup>

In most cases, then, it will be possible for the buyer to effectively place the burden of possible strict liability claims on the seller of the assets, which is exactly the result that tort policy would dictate.<sup>138</sup> This can be done either by reducing the price paid for the assets, the most effective and least complicated alternative, or by requiring the seller to take other action such as setting up an escrow account or procuring or maintaining products liability insurance. While it is possible that the extra expense or lower market value may cause the seller to dispose of its assets individually, a company going out of business will most likely still find it financially advantageous to sell its assets as a unit, receiving at least a modicum of additional compensation for good will.<sup>139</sup>

The method of dealing with strict products liability and successor corporations proposed in part four above<sup>140</sup> will still leave without remedy some plaintiffs injured by dangerously defective products. The unlucky soul who finds himself or herself injured by a product manufactured by a corporation that has simply liquidated or dissolved, or by one that has sold its assets to a buyer that is able to rebut the presumed strict liability assumed by the purchase, will be left to his or her own devices.<sup>141</sup> Although this is not necessarily a desirable state of affairs, the purpose of the analysis above is not to show that the victim of a defective product should be compensated regardless of who possesses the assets that manufactured the product. The intent is to make successor corporations responsible in situations in which it is in the best interests of both the victim and society as a whole. When the successor has not benefited in any discernible way as a continuation of the transferor, to impose strict liability for products manufactured by the transferor is neither just nor socially

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135. *Extension of Products Liability*, *supra* note 24, at 611 n.149.

136. Note, *Products Liability for Successor Corporations: A Break from Tradition*, 49 COLO. L. REV. 357, 378 (1978).

137. See *supra* text accompanying notes 126-27.

138. See *supra* text accompanying notes 20-22.

139. Juenger & Schulman, *Assets Sales and Products Liability*, 22 WAYNE L. REV. 39, 57 (1975).

140. See *supra* text accompanying notes 99-124.

141. These victims may be eligible for relief in the form of worker's compensation, social security, and other similar benefits vesting as a result of injury or death.

desirable. "At some point the interest favoring corporate acquisitions will appear to outweigh those interests underlying the risk of loss theory in product-liability cases."<sup>142</sup>

## VI. CONCLUSION

The history of strict liability is one of conflict between an emerging doctrine and numerous previously inflexible rules that had to be pushed aside. Before *MacPherson v. Buick*<sup>143</sup> negligence in the manufacturing process had to be shown before recovery for a defective product was possible. *Henningsen v. Bloomfield Motors*<sup>144</sup> and *Greenman v. Yuba Power Products, Inc.*<sup>145</sup> abolished the previously insurmountable obstacles of warranty and contractual privity requirements. The battleground has now shifted from the structure of the rule to its scope. In *Cyr v. B. Offen & Co.*<sup>146</sup> the First Circuit became the first court to hold a cash purchaser of assets liable for injuries caused by an unsafe design implemented by the previous owner of the assets<sup>147</sup> and to signal an assault on yet another mainstay—the rule of corporate successor nonliability in the absence of an express assumption thereof.

Courts have gradually become sensitive to the plight of those who must rely on increasingly complex products that they do not understand and from which they cannot protect themselves. Strict products liability policy recognizes, further, that this is not an individual problem but one of general social concern—it affects all of us, whether or not we actually use these products ourselves. The cost of industrial technology should therefore properly be shared by society as a whole, if possible, or by the party best able to spread the risk. The strict products liability doctrine purports to do exactly that.

The purpose of the strict liability doctrine, however, has never been to expose manufacturers to liability for injuries with which they have no connection or obligation to rectify. The purpose of the doctrine is to remove unreasonable barriers to recovery.<sup>148</sup> In the words of one commentator, "Strict liability has never meant liability without responsibility for the defect."<sup>149</sup> "Responsibility" for a defective product means having created the risk of injury; it is rightly placed on the manufacturer of the product.<sup>150</sup> If the corporation that manufactured the defective product changes hands, it is fair, reasonable, and good public policy to transfer the responsibility to the successor, provided the successor is benefitting from the transfer as a continuation. Once

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142. *Extension of Products Liability*, *supra* note 24, at 611.

143. 217 N.Y. 382, 111 N.E. 1050 (1916).

144. 32 N.J. 358, 161 A.2d 69 (1960).

145. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

146. 501 F.2d 1145 (1st Cir. 1974).

147. 10 CUM. L. REV. 633, 638 (1979).

148. See generally W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 641-58 (4th ed. 1971).

149. Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142, 153 (1980).

150. See *supra* text accompanying notes 20-22.

this principle is established, transactions can be structured so that financial responsibility for defective products remains with the original manufacturer.

An alternative method of providing products liability protection to all plaintiffs would be to enact a comprehensive legislative scheme having this effect.<sup>151</sup> Because of the fundamental policy clash between strict tort liability and corporate law<sup>152</sup> and the resulting inconsistency of judicial interpretations,<sup>153</sup> this may be the most effective way to achieve certainty.<sup>154</sup> Although an increasing number of states have some kind of products liability legislation under consideration,<sup>155</sup> most of this legislation is aimed at slowing the growth of products liability claims by placing date-of-sale limitations on claims or ceilings on recoveries.<sup>156</sup> Of particular interest is the possibility of insurance statutes requiring products liability coverage for the life of all products manufactured.<sup>157</sup> If the cost of that coverage were not prohibitive, this would appear to be the best overall solution to the problem of successor strict products liability.

The law of strict products liability of successor corporations is in a state of uncertainty.<sup>158</sup> Unless the parties effect a statutory merger or expressly agree to delegate the liability among themselves, both the corporations and the injured plaintiff must cast their lot to the courts, whose only tools are a general rule meant to protect creditors and some inconsistently interpreted exceptions.<sup>159</sup> A rule that presumes successor corporations to be liable for defective products manufactured by their predecessors, yet allows the presumption to be negated by a showing of no benefits to the successor corporation as a continuation of the transferor, would establish a fair and consistent framework for determining transferee liability.<sup>160</sup> The certainty provided by a

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151. Note, *Products Liability and Successor Corporations: A Break From Tradition*, 49 COLO. L. REV. 357, 375-78 (1978). In fact, it has been argued that this is one major problem with *Ray v. Alad Corp.*, 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977). Judicial protection for all plaintiffs in the narrow class of those bringing suit against successor corporations on a continuation theory may reduce the impetus for comprehensive legislative reform of strict liability laws by diminishing the class benefitting from such reform. Note, *Products Liability and Successor Corporations: A Break From Tradition*, 49 COLO. L. REV. 357, 375 (1978).

152. See generally *supra* notes 14-39 and accompanying text.

153. See generally *supra* notes 47-98 and accompanying text.

154. See Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86, 110 (1975); Note, *Products Liability for Successor Corporations: A Break From Tradition*, 49 COLO. L. REV. 357, 375 (1978). In *Leannais v. Cincinnati, Inc.*, 565 F.2d 437 (1977), the court refused to impose the *Ray v. Alad Corp.* decision on Wisconsin courts because "such broad public policy issues are best handled by the legislature with their comprehensive machinery for public input and debate." *Id.* at 441.

155. In 1975 there was not a single state statute directly addressing the problem of successor corporation liability for products manufactured by a corporate predecessor. Two years later 39 states had some form of successor corporation products liability statute under consideration. Note, *Products Liability and Successor Corporations: A Break From Tradition*, 49 COLO. L. REV. 357, 375 (1978).

156. *Id.* at 375-76. It has been argued that these types of statutes do not constitute procedural defenses, but in fact abolish substantive rights. If this is the case, a "legitimate legislative purpose" must be established if violations of federal due process and equal protection guarantees are to be avoided. *Id.* at 377 n.117.

157. See *supra* notes 133-35 and accompanying text.

158. See *supra* text accompanying notes 47-98.

159. *Id.*

160. See *supra* text accompanying notes 99-124.

uniform approach would aid successor corporations in planning for potential liabilities or losses. If this framework were established, corporations would at last be able to structure transactions in ways that simultaneously reflect their intentions and protect those injured by dangerously defective products.

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